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August 1, 1996



Office of the Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

RE: In the Matter of Federal-State Joint Board on Universal Service
FCC 96-93; CC Docket No. 96-45

Dear Secretary:



Pursuant to FCC Rules, Sections 1.415 and 1.419, enclosed is the original and four copies of the Supplemental Comments of the Washington Utilities and Transportation Commission (including two copies marked "Extra Public Copy") regarding the above referenced matter.

Sincerely,

STEVE KING
Acting Secretary

Enclosures

Before the
Federal Communications Commission
Washington, D.C 20554



FCC 96-93

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| In the Matter of | ) | |
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# COMMENTS IN RESPONSE TO SUPPLEMENTAL QUESTIONS

OF

JOINT BOARD STAFF ON UNIVERSAL SERVICE

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## I. INTRODUCTION AND SUMMARY

The Washington Utilities and Transportation Commission (UTC or Commission) welcomes the opportunity to provide additional information to assist the Joint Board in addressing the universal service issues presented by the Telecommunications Act of 1996 ("the Act" or "the 1996 Act").[1] The Commission filed both opening and reply comments in response to the FCC Notice of Proposed Rulemaking (NPRM) of March 8, 1996. In these comments, the Commission makes several major points.

Definitions. The Commission advocates the determination of affordability by the states rather than the imposition of a national benchmark. Competition should be recognized as a primary force for the achievement of affordable rates.

Schools and Libraries. The Joint Board and the FCC should avoid the creation of a new "entitlement" program. The Commission does not support the creation of massive subsidies for inside wiring or free rates for public institutions. The discount price should be calculated on the basis of the tariffed or price-listed rates. The resale provisions of Section 254 should be construed only to prohibit the resale of services for profit.

High Cost Fund. Accounting methodologies for the high cost fund should be modified to include only costs from accounts that are directly affected by rural/remote characteristics.

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[1] Pub. L. No. 104-104, 110 Stat. 56, 71 (1996), *to be codified at* 47 USC § 151 *et seq.*

SLC/CCL. The Washington UTC has determined in the recent USWC rate case that there is no local service subsidy and that the CCL has outlived its usefulness as a specific rate element of switched access.

LOW-INCOME CONSUMERS. The low income mechanisms currently in place work well and should not be made the target of major revisions. The 1996 Act specifically precludes modifications to the Lifeline program.

## II. DEFINITIONS ISSUES

**1. Is it appropriate to assume that current rates for services included within the definition of universal service are affordable, despite variations among companies and service areas?**

It cannot necessarily be assumed that current rates are "affordable." Affordable may be "whatever price the customer is accustomed to currently," but if penetration rates are low in a given area, current rates may not be affordable. For certain consumers, current rates for services included within the definition of universal service may be "affordable" only because of conceptual considerations of non-rate factors such as prices of other services not included within the definition of universal service. Affordability may also be partially determined by local calling area size, population density, or socio-economic indicators, some of which also vary by region. Depending on whether the serving company's costs and prices are tracking well with non-rate factors, current prices may or may not be affordable,

without regard to variations between companies or service areas. Local regulators are best equipped to determine affordability.

Equal emphasis should be placed on two additional concepts. An effectively competitive market will be the most efficient way to achieve affordable rates, which will in turn depend on market-based price signals that are based on cost. If affordability is determined without regard to variations in cost of service, then an effectively competitive market may fail to develop. It will be best not to drive a benchmark stake in the national landscape. Such a mechanism is likely to cause all sorts of artificial distortions as the market adjusts to a new equilibrium that may or may not be based on cost.

**2. To what extent should non-rate factors, such as subscribership level, telephone expenditures as a percentage of income, cost of living, or local calling area size be considered in determining the affordability and reasonable comparability of rates?**

Price is not the only determinant of consumer demand. The non-rate factors listed are good examples of the kind of data local regulators are best equipped to analyze and consider in determining affordability. Since such factors are determinants of demand, and since some important factors vary regionally, it is critical that states play the ultimate role in determining affordability. Local regulators are most likely to be familiar with current conditions in their home states. A serious drawback in failing to consider non-rate factors is illustrated in the discussion in response to question 1 above A national benchmark rate, while

reflecting a hypothetically correct average in terms of its relationship to cost, might cause artificial distortions in the allocation of resources. In turn this could distort the prices of other services compared to price levels set in an effectively competitive market, which would take into account such factors as differences between companies and service areas.

**3. When making the "affordability" determination required by Section 254(I) of the Act, what are the advantages and disadvantages of using a specific national benchmark rate for core services in a proxy model?**

The advantages might be in streamlined regulation through the simpler form of ratemaking that might ensue, streamlined administration of the regulatory process, lessened responsibilities and expenses for federal and local regulators, and lessened regulatory expenses for regulated companies, customers, and the public. Furthermore, differences in rates between regions might be smoothed out, and those states whose rates might migrate downward would enjoy the rate decrease.

The disadvantages would probably accrue to end users in states where the specific national benchmark rate for core services would be higher than current rates for core services. Perhaps the strongest drawback to this type of approach is that it would be very detrimental to the development of effective local competition, because prices for core services would run the danger of being unrelated to the actual marginal cost of service. We run the risk that benchmark rates will be higher than those produced by a competitive market. A competitive market is most

likely to be successful in taking into account non-rate factors affecting consumer demand, and in keeping rates as close to marginal cost as possible.

In our previously filed comments, the Commission has recommended that the FCC avoid a "one size fits all" approach and we restate that concern here. While a national rate has the appeal of simplicity of administration, it cannot account for the wide variation in local conditions. The determination of affordability should leave maximum flexibility to the states to address local circumstances.

**4. What are the effects on competition if a carrier is denied universal service support because it is technically infeasible for that carrier to provide one or more of the core services?**

Clearly the carrier will be at a disadvantage relative to another more technically competent carrier that might receive support. However, there is little benefit in providing universal service support unless core services are provided. The fund should be used only for its intended purpose. A carrier wishing to receive universal service support should provide an appropriate range of services consistent with the definition of universal service adopted in this proceeding. If a carrier who cannot offer the required range of service is nevertheless aided in entering the market by its receipt of support, competition suffers. The new carrier does not offer customers a choice across the full range of service, and by entering the market, may lessen the likelihood of another carrier entering who can offer the service.

**5. A number of commenters proposed various services to be included on the list of supported services, including access to directory assistance, emergency assistance, and advanced services. Although the delivery of these services may require a local loop, do loop costs accurately represent the actual cost of providing core services? To the extent that loop costs do not fully represent the costs associated with including a service in the definition of cores services, identify and quantify other costs to be considered.**

In its recent U S WEST rate order, the Washington UTC determined that the cost of the local loop is separate from the cost of providing local service.[2] The loop cost is a shared cost which is to be allocated among all the services which use the loop. Under this approach, therefore, the costs associated with providing a core service would be calculated separately. The UTC approach is detailed in the attached order.

Another point is relevant here. In its previous comments, the Commission has expressed its concern with an approach which defines universal service on the basis of a list of services and technical specifications. The UTC has urged the Joint Board and the FCC to design a description of universal service which is more

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[2]*Washington Utilities and Transportation Commission v. U S WEST Communications, Inc.*, Docket No. UT 950200, Fifteenth Supplemental Order, April 11, 1996 ("USWC Rate Order"). See e.g., discussion pp 10, 83-85. A copy of the order is attached as Appendix A.

functional in nature, focusing on availability of and access to network capabilities and customer demand rather than services.[3]

## III. SCHOOLS, LIBRARIES, HEALTH CARE PROVIDERS

**6. Should the services or functionalities eligible for discounts be specifically limited and identified, or should the discount apply to all available services?**

As a general proposition, the scope of discounts should be as narrowly defined as possible so as to limit the size of the support fund required. The question to be asked is whether the goal is universal affordable access or whether the goal is to establish a discount program tied to specific services which receive defined subsidies. The latter approach carries the risk of simply creating an "entitlement" style of program which is undesirable in the long run. If the goal is broader, support can be limited to areas where the market fails to make access available and affordable.

**7. Does Section 254(h) contemplate that inside wiring or other internal connections to classrooms may be eligible for universal service support of telecommunications services provided to schools and libraries? If so, what is the estimated cost of the inside wiring and other internal connections?**

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[3]Comments of the Washington Utilities and Transportation Commission, April 10, 1996, pp. 7-9.

Section 254 of the Act does not mandate that universal service funds be used to provide inside wiring for every classroom in the United States. While it is possible to make an argument that the language refers to classroom-by-classroom provision of service, the Act is far from clear on this point. If Congress had intended to require such a result, it certainly could have accomplished it in explicit terms.

Even if the Act allows such an interpretation, policy and practical reasons argue against funding for inside wiring for every classroom. The costs would be enormous. The NII Advisory Council's Kickstart Initiative report estimates the startup cost of inside wiring at $6.7 billion, with a recurring cost of $1.4 billion. As the UTC noted in earlier comments, this represents only a portion of the funds necessary to bring technology effectively into schools. A 1995 study by the Milken Family Foundation estimated that it will take $31.5 billion in additional funds to wire the nation's schools, buy software, train teachers and put four to six computers in each classroom. Washington's share, given its size and population could exceed $1 billion.[4]

The inside wiring approach is further flawed in that it interferes with local initiative and fails to allow demand to determine what services are needed, or to allow competition to provide those services at affordable prices. Instead, in a top-

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[4]Building The Road Ahead: Telecommunications Infrastructure in Washington State, First Report of the Governor's Telecommunications Policy Coordination Task Force, April 1996 ("Task Force Report"), p.93. The Task Force characterized this as "prohibitive without other offsetting benefits to communities across the state." A copy of excerpts from the report is attached as Appendix B.

down, "centralized planning" fashion, the approach assumes that wiring every classroom in the country is desirable from the point of view of local educators and parents. The better approach would be to allow local, state, and federal initiatives, to develop their own community based plans.

In Washington, the Governor's Telecommunications Policy Coordination Task Force issued its first report in April 1996. The report addresses, among many issues, questions relating to educational technology. The report echoes some of the UTC's concerns regarding the effect of discount tariffing for educational institutions. It also details planning efforts to deploy infrastructure and addresses cost issues. (See Appendix B).

**8. To what extent should the provisions of Sections 706 and 708 be considered by the Joint Board and be relied upon to provide advanced services to schools, libraries and health care providers?**

Sections 706 and 708 should be considered by the Joint Board and relied on as part of the solution to universal service issues. Reliance on these sections is consistent with an approach that allows states and local jurisdictions to take the lead in determining how best to meet universal service goals for schools and libraries. It is important at the same time, however, that Section 706 not be interpreted as an invitation to "second guess" and pre-empt state decisions.

**9. How can universal service support for schools, libraries, and health care providers be structured to promote competition?**

The program should be set up to allow the maximum amount of choice for schools, libraries and hospitals. The universal service program should focus on bare essentials and allow communities to pull together their own resources and demand to establish more advanced services. Schools, in cooperation with their teachers, administrators, parents and other community members, must determine what best suits their needs. Then they should look to the resources and opportunities available in their community to fund such purchases. A universal service program should only get involved in situations where the market is not able to provide affordable rates.

**10. Should the resale prohibition in Section 254(h)(3) be construed to prohibit only the resale of services to the public for profit, and should it be construed so as to permit end user cost based fees for services? Would construction in this matter facilitate community networks and/or aggregation of purchasing power?**

The Washington Commission agrees that the resale prohibition in Section 254(h)(3) should be construed to prohibit only the resale of services to the public for profit. An end-user cost-based fee for service should be permitted. As addressed in our previous comments in this docket, this provision may impede current and planned infrastructure sharing and demand aggregation arrangements which promise to advance the goals of the Act

In Washington State, the Legislature has launched plans for a K-20 network which combines existing computer tie-ins with satellite linkups, increased use of the Internet, video teleconferencing and interactive video. While not yet fully funded, the plan hopes, in several phases, to connect colleges, universities, educational service districts, elementary schools, libraries and other users.

In Seattle, the school district is linking hundreds of computers in its 93 school buildings in a network that will provide a majority of its 2,800 classrooms with access to the Internet by the end of this year.[5] The work will be done mostly through volunteers. These efforts are occurring independently of any federal subsidy at present, but they should not be penalized should funding or subsidy be made available simply because they involved linking with noneligible parties--parties that by virtue of their added demand have helped make the plan more feasible.

These efforts are initial and fragile and may well be jeopardized by a reading of the resale limitation which threatens the viability of cooperative ventures.

**11. If the answer to the first question in number 10 is "yes," should the discounts be available only for the traffic or network usage attributable to the educational entities that qualify for the Section 254 discounts?**

Where demand aggregation arrangements exist, it is appropriate for discounts to be provided only for traffic or usage attributable to eligible entities.

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[5]Seattle Post-Intelligencer, July 4, 1996, p. 1. Copy attached as Appendix C.

**16. What should be the base service prices to which discounts for schools and libraries are applied: (a) total service long-run incremental cost; (b) short-run incremental cost; © best commercially-available rate; (d) tariffed rate; (e) rate established through a competitively-bid contract in which schools and libraries participate; (f) lowest of some group of the above; or (g) some other benchmark? How could the best commercially-available rate be ascertained, in light of the fact that may such rates may be established pursuant to confidential contractual arrangements?**

The Washington Commission recommends that the discount be calculated based on the tariffed or price-listed rate. This approach will tend to minimize the amount of support which will be required, as compared with the other options listed. This should not preclude groups of users from combining their bargaining power to obtain discounts based on competitive bidding, best-commercially available rates, or other methods.

It should also be noted that the language of the Act provides guidance here. By referring to "rates less than the amounts charged for similar services to other parties", Section 254(h)(1)(B), Congress appears to intend that the reference point be rates currently charged. These rates are to be found in tariffs or price lists in most cases.

One proposal made to the FCC suggests that telecommunications services be provided to schools and libraries at no charge. The Washington UTC does not support this proposal. The intent of the Act is to limit and target universal service

to areas where it is essential, while avoiding anti-competitive and costly subsidies. Providing service at no charge to institutions in the long run simply creates an entitlement system which is not sustainable. As we have stated in our prior comments, competition is the most effective way to meet legitimate demand for service.

**17. How should discounts be applied, if at all, for schools and libraries and rural health care providers that are currently receiving special rates?**

Washington does not provide special rates for schools, libraries, and health care providers as a statutory or regulatory mandate. Some special rates may exist as a result of competitive conditions. To the extent "special rates" are in place, the goal of the Act has been met, and further regulatory intervention is not appropriate.

**19-21. Additional discounts**

The 1996 Act does not mandate additional "discounts" for schools, libraries, and rural health care. The discount mechanism is limited to the circumstances set out in Section 254(h)(1) and should not be expanded. Expansion of universal service funding on this basis is not consistent with the goal of limited, targeted support, or of allowing competition to work. In Washington state, the issue is essentially moot, because of the prevalence of statewide average rates. To the extent that mechanisms are adopted to resolve urban/rural comparability problems, these should be allowed to operate independently and assist all customers, including public institutions, rather than creating additional discount programs.

**22. Should separate funding mechanisms be established for schools and libraries and for rural health care providers?**

Creating a separate funding mechanism for schools and libraries, as opposed to health care facilities, is the most appropriate approach. The Act treats the two categories of customers separately and determines the preferential rate in a different fashion. As we argued in our reply comments, the Joint Board and the FCC should preserve the current approach of segregating support into separate funds according to the purpose for which it is intended. Separate funds tend to make the support more explicit, a goal of the Act.

**23-25. Cost Estimates**

The Commission cannot comment specifically on the accuracy of the cost estimates contained in the McKinsey Report and the NII KickStart Initiative. The size of the fund estimated by the NII KickStart Initiative report, $6.7 billion initial investment and $1.4 billion annual recurring costs, underlines our position that the FCC should not embark on the establishment of a costly and centralized program for schools and libraries under the banner of universal service.

Washington's Superintendent of Public Instruction called last year for $477 million in funding for educational technology including universal broadband to schools, two-to-one student/computer rations in classrooms, and laptop computers for overnight checkout, among other items. The Governor's Task Force report has subsequently suggested that this figure may be very conservative.[6]

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[6]Task Force Report, p. 91, Appendix B.

Recent developments in the Seattle School District are illustrative of some of the issues. In February 1996, the school district presented a $75 million dollar tax levy for school technology to the voters, who rejected the proposal.[7] The levy would have paid for wiring, equipment, training and support staff. Notwithstanding the levy failure, an alliance between the school district, local business, city and state government is moving ahead with plans to connect classrooms with the Internet. By some estimates, the new approach could save $16 million dollars of the original amount of the levy. The school district plans to take advantage of a number of resources including a new state K-20 school technology plan, volunteer assistance with wiring the schools, and a Seattle city government requirement that the local cable provider, TCI, deploy fibre optics along major streets.

These developments in Seattle, as well as the developments addressed in the Task Force Report, underscore the need to allow state and local initiatives to evolve which will meet universal service needs in communities in an appropriate manner. Seattle schools are benefitting from a cooperative approach between schools, business, state and local government, and volunteers. Any policies adopted by the Joint Board and the FCC should take care not to stifle these efforts by imposing uniform national solutions. The Seattle example also illustrates the still uncertain nature of demand for advanced services. In a city with a good record of supporting education, and a significant high-technology community, the

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[7]See Appendix C.

school technology tax levy nonetheless failed. In part this may be an indication that demand for advanced services in schools is still evolving. The issue facing the FCC and Joint Board is whether it is appropriate to direct the deployment of technology on a mandatory "top down" basis, based on the premise that demand exists, and to allocate major revenue flows to the purpose. A better approach is to permit sufficient flexibility to accommodate local and state initiatives, and to allow competition to meet the demand, as it evolves.

## IV. HIGH COST FUND

**General Questions**

**26. If the existing high-cost support mechanism remains in place (on either a permanent or temporary basis), what modifications, if any, are required to comply with the Telecommunications Act of 1996?**

The existing high-cost support system should be modified to include additional accounting safeguards to book, track, and report appropriate revenues to explicit accounts. Rules should be adopted to ensure that any high-cost funds shall be used for the intended purpose of the fund, to maintain affordable local rates.

**27. If the high-cost support system is kept in place for rural areas, how should it be modified to target the fund better and consistently with the Telecommunications Act of 1996?**

The fund should be modified as follows:

a. It should only include costs from the accounts that are directly affected by the rural/remote characteristics of the serving area. These would include Accounts 6110, 6120, 6210, 6230, 6410, 6510, 6560 (Depreciation - but only on plant accounts for which expenses are included in the accounts listed above), and some pieces of 6620 (services). Accounts to be excluded from high cost support would include: marketing, billing, G&A expenses, and executive expenses.

b. Competitive carriers serving local customers would also be allowed to participate in the fund, if they could provide documentation of the types of costs listed above, either facilities-based or through resale. They would not necessarily be required to maintain books and records under the Uniform System of Accounts. Their costs should be scrutinized and adjusted if necessary to eliminate start-up effects (high initial cost, low initial usage).

**28. What are the potential advantages and disadvantages of basing the payments to competitive carriers on the book costs of the incumbent local exchange carrier operating in the same service area?**

<u>Advantages:</u>

a. The cost data is easy to obtain, since the existing LECs file the data based on Part 32/36.

b. Use of book costs might encourage resale of embedded LEC facilities while allowing competition, since competitors may be more likely to want to serve an area using LEC facilities if they are compensated for doing so.

c. Book costs might serve as a good proxy during competitors' startup periods, when competitors have low traffic and high initial costs.

Disadvantages:

Book costs may not reflect newer less-expensive technology (e.g., wireless) used by competitors. That would result in over recovery by competitors at the expense of all contributors to the fund.

**29-30. Price cap companies**

The Washington UTC would oppose any blanket prohibition against eligibility of price cap companies for support. This issue should be decided by state commissions on a case-by-case basis.

## V. SLC/CCLC

**69. If a portion of the CCL charge represents a subsidy to support universal service, what is the total amount of the subsidy? Please provide supporting evidence to substantiate such estimates. Supporting evidence should indicate the cost methodology used to estimate the magnitude of the subsidy (e.g., long-run incremental, short-run incremental, fully-distributed).**

The Washington UTC found, in its recent USWC rate case decision, that there was no local service subsidy.[8] With respect to the CCLC, the Commission determined that the CCLC was best eliminated as a specific rate element of switched access, stating that "[t]o allow the CCLC to continue to exist is to imply, inaccurately, that local exchange services require a 'subsidy' from toll."[9] The Commission further concluded:

> The CCLC has outlived its function and it is time to retire it as a specific rate element of switched access. By eliminating the CCLC, the Commission is not excusing toll carriers from responsibility for supporting the shared and common costs of the network it uses to reach its customers. On the contrary, the revenues assigned to switched transport and switching still include a significant contribution to shared and common costs. However, there is no longer a reason to treat one shared cost -- the local loop and NTC-COE -- differently from the many other shared and common costs of the

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[8] *USWC Rate Order*, See e.g., discussion pp 10 83-85.

[9] *Id.*, p. 113

firm. It is reasonable and appropriate for access charges to contribute to the recovery of shared costs -- including the local loop -- but the assignment of costs using the CCLC is no longer warranted.[10]

The cost methodology used by the Commission is based on TSLRIC. The methodology and cost study issues are discussed in the rate order beginning at page 80.

**70. If a portion of the CCL charge represents a contribution to the recovery of loop costs, please identify and discuss alternatives to the CCL charge for recovery of those costs from all interstate telecommunications service providers (e.g., bulk billing, flat rate/per-line charge).**

A rate/per-line charge would be better that the current minute of use charge, and would be most consistent with the WUTC's decision in Docket UT-950200. The "flat rated port charge" is more consistent with the way costs are caused and avoids over-recovery. Bulk billing on a flat rated port charge would also be acceptable. As noted above, however, we believe that it is reasonable for access charges to contribute to the recovery of shared costs, as opposed to a method where all the costs are recovered through a charge on end-users.

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[10] *Id.*

## VI. LOW-INCOME CONSUMERS

**71. Should the new universal service fund provide support for the Lifeline and Linkup programs, in order to make those subsidies technologically and competitively neutral? If so, should the amount of the lifeline subsidy be tied, as it is now, to the amount of the subscriber line charge?**

As stated in earlier comments in this docket, the UTC believes that low-income mechanisms currently in place are working well and should not be made the target of major revisions. The Commission has serious concerns about any proposal to remove the Link Up program from the jurisdictional separations rules. (Opening Comments, p. 13). With regard to Lifeline, the Commission has expressed serious questions about any review of Lifeline, given the language in Section 254(j) specifying that nothing in the section "shall affect the collection, distribution, or administration of the Lifeline Assistance Program...."

## VII. CONCLUSION

The Washington Utilities and Transportation Commission urges the Joint Board to adopt universal service policies which preserve state and local flexibility to meet unique local conditions and which foster the development of local solutions to telecommunications needs. The Joint Board should avoid the creation of costly subsidies mechanisms for schools and libraries which in the end will only burden customers and companies and impede the development of competition.

The Washington UTC looks forward to further participation and further opportunity to comment on these matters before the Joint Board and the FCC.

DATED this 1st day of August 1996, at Olympia, Washington.

RICHARD HEMSTAD, Commissioner
Washington Utilities and Transportation Commission

WILLIAM R. GILLIS, Commissioner
Washington Utilities and Transportation Commission